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OUTLOOK

Bubble, Bubble, Toil and Trouble

What's the quickest way to get an investment banker or private equity fund to call you back? Just mention in your next press release that you're a fast casual restaurant or better yet, you serve artisan pizza. Then, sit back and let the phone ring.

Now that the better-burger segment has taken a coffee break from relevance in order to close stores, consolidate franchisees and the like, the private equity chieftains, angels, hedge funders and other members of the "smart money" club have turned their investment broomsticks to fast casual restaurants in general, and the quick-pizza segment in particular.

Pizza is the new manna from heaven, especially the kind that's served up Subway style and baked in wood burning, 800-degree ovens. Artisan pizza shops are so popular these days they are multiplying faster than better burgers and bakery cafes, and even faster than froyo shops.

The big players are investing in the artisan pizza segment, too, like Buffalo Wild Wings and their investment in Pizza Rev, and Lee Equity Partners and Papa Murphy's stake in Project Pie. Even Chipotle, hardly satisfied with their cult status and Google-like multiple, is playing footsie with Pizzeria Locale, a Boulder, Colo.-based artisan pizza shop.

Why are investors and strategics so focused on the new up-and-coming fast casual pizza concepts?

The cynical answer shouldn't surprise regular Monitor readers. First, the Federal Reserve floods the country with trillions of newly printed dollars. This sends investors scrambling for yield and eventually forces money down the risk curve. The funds must become venture capitalists to place all the money entrusted to them, so eventually, the investment case turns to pizza parlours.

Ok, that's the cynical view. The truth is these pizza chains are new and serve fresh food, and consumers like to try new things. And, a number of these modern-day pizza joints have reasonably strong sales and margins. That draws a big crowd and in the restaurant business, variation upon variation.

There is one thing investors should keep in mind, though. There has never been a riskier asset class than restaurant startups.

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The Bipolar Restaurant Industry

You can be excused if you felt confused by the events in the restaurant industry last week.

In the span of five days, the pizza chain Sbarro filed for bankruptcy, again, Zoe's Kitchen and then Papa Murphy's submitted IPO filings, and then Quiznos culminated its lengthy implosion by filing its long-awaited bankruptcy. Trying to make sense of the industry right now by reading headlines will give you a giant headache.

The restaurant environment is bipolar. Some chains are thriving, attracting customers and sky-high valuations and big premiums on Wall Street. Others literally can't buy a customer. They struggle to survive, but carry on because they have a brand name and franchisees willing to keep operating stores. More restaurant chains became zombies the past five years than in the previous 50.

"Competition is fierce," said Adam Friedman, attorney with the bankruptcy group at the law firm Olshan Frome Wolosky. He worked on the Fox & Hound Restaurant Group bankruptcy. The company was sold to its second lien lender, Cerberus Capital Management. "There are many concepts and chains competing for the same customers. And this competition is occurring at a time when consumers have less money to spend. When the customer does look to spend, it appears they are looking to go to updated and fresh concepts."

This is the market the industry must navigate today. For decades, as consumers increased how much they ate out, restaurants could open new units and attract customers simply by putting a sign on the door. That's no longer the case today.

Consumers have reduced their restaurant consumption, either because they live in households with a stay-at-home parent, they're retired, or they just don't have the money following years of stagnant wages and recession. So when consumers do eat out, they want to make those occasions count. This puts the onus on restaurants to perform like never before. The companies that submitted this month's flurry of bankruptcy and IPO news demonstrate this.

Papa Murphy's has slowly built its national chain of take-and-bake pizza places. The company calls itself a restaurant, but it's more of a grocery store that serves just one really good product.

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FINANCE SOURCES

Bank of America Targets Franchises for Small Business Loans

Bank of America has added another line of business to its franchise offerings, which is conventional loans from $25,000 to $2 million.

"When we started to research the franchise space in general, it was apparent there were a lot of SBA banks in the sector," said **Kristy Hall**, Bank of America Small Business Programs Manager. If they were going to make a mark in the space, it was going to be by offering conventional financing for smaller loans.

Bank of America Merrill Lynch has long been in the restaurant industry (starting as far back as 1959 financing McDonald's locations), funding the franchisor itself or a non-franchised multi-unit company, as well as financing larger multi-unit restaurant franchises. And the deal sizes are typically larger.

Adding the small business effort within the restaurant sector plays well for the bank, being able to meet even more needs for franchisors.

Each franchisor has different requirements, Hall said, and her group first has to meet with the franchisor to understand their growth plans, and then what the franchisees need, such as reimaging, for example.

"We are doing the due diligence on the franchisor up front," said Hall. They are looking for strong, well-known brands that are sustainable and still have growth potential. Underwriting the franchisor first allows them to offer the conventional financing to the franchisees.

"Not all brands are created equal," said **David Solis**, national sales executive, small business specialized sales with Bank of America. "We look at bank reports, their reputation, history, number of units. Through the process of identifying what their goals are, we start to determine whether this is someone who we want to work with—and do they want to work with us?"

To underwrite franchisees, the bank examines credit scores, liquidity amounts and debt levels. And if they "run into a larger multi-unit franchisee" within that system, he said, "we can work with our up-market partner to facilitate something over that ($2 million) amount," he added.

In addition to financing franchisees, the bank also can offer ancillary services at the corporate level such as merchant processing and other solutions. "We can bring in other teammates to help execute and have greater efficiencies with their corporate strategy," Solis said.

Hall herself likes the franchise sector: "Knowing the system, understanding it, provides less risk because of that predictability" a franchise has to offer, she said. "And it adds so much to the economy, and represents job creation."

For more information on Bank of America Small Business Specialized Sales, contact **Kristy Hall**, *small business programs manager, at (302) 432-1273, or by email at kristy.hall@bankofamerica.com.*

Recent GE Capital Deals

GE Capital, Franchise Finance recently announced the following transactions:

• Provided $80 million in senior debt to **BurgerBusters Inc.**, a Taco Bell franchisee. GE Capital served as administrative agent and GE Capital Markets served as lead arranger and bookrunner on the transaction.

BurgerBusters will use the capital to refinance existing debt and to purchase some of its restaurant locations. Based in Virginia Beach, Va., it operates 83 Taco Bell restaurants.

• Provided **Armadillo Ventures, LLC**, a Texas Roadhouse franchisee, with a $12 million senior credit facility comprised of a $9 million term loan and a $3 million development line of credit. The funds will be used to refinance existing debt and to build and operate a new restaurant location.

Founded in 1997, Armadillo Ventures owns six Texas Roadhouse locations in Maryland and Delaware.

• Provided $43 million in senior credit to **WKS Restaurant Corp.** The credit facility was used to substantially recapitalize the company. GE Capital served as administrative agent and GE Capital Markets served as sole lead arranger and bookrunner on the facility.

WKS, based in Lakewood, Calif., is the largest El Pollo Loco franchisee, with 59 locations in California, Arizona and Utah. WKS also operates 21 Denny's, 18 Krispy Kreme Doughnuts and two Corner Bakery locations in six states.

GE Capital, Franchise Finance is a lender for the U.S. franchise finance market via direct sales and portfolio acquisitions. With more than 30 years of experience and over $7 billion in served assets, it provides financing to more than 2,000 customers and 14,000 properties. The business specializes in financing mid-market operators with multiple stores in the restaurant and hospitality industries. For more information, visit gefranchisefinance.com.

Brookwood Completes Large Recap for Pizza Hut Franchisee

Brookwood Associates, an investment banking firm that specializes in multi-unit restaurant companies, recently represented **ADF Restaurant Group** in a recapitalization for the company. **Ares Capital Corporation** served as administrative agent and lead arranger in a $70.5 million senior secured credit facility in the recap. The result was a renewed capital structure and greater equity control for the current management team. ADF and affiliates is the largest franchisee of Pizza Hut restaurants in the Northeast and the second largest Pizza Hut franchisee in the United States.

Brookwood Associates provides advisory services to its clients in the areas of mergers and acquisitions, corporate financing, restructuring, fairness opinions and other areas. For more information, contact **Jeb Ball**, *managing director, at jeb@brookwoodassociates.com, or by phone at (704) 705-3654.*

Noah Bank Services Minority Franchisees and More

They've financed a supermarket for Dominicans in the Bronx, and they funded a kosher chicken processing plant in a Jewish community in New York. Their mandate is to serve the community they are in, and now, for **Noah Bank**, that includes franchisees.

The bank's geographic footprint is in Pennsylvania, Northern New Jersey, Manhattan and Flushing, New York and the Metro DC area, and they've been charged to serve the minority communities in those regions.

Noah Bank was launched in 2006 as a division of Royal Bancshares of Pennsylvania. The idea was to create a division that would help Royal Bancshares meet their Community Reinvestment Act (CRA) goals. (The Community Reinvestment Act is a federal law designed to encourage banks to meet the needs of all segments in their community, including middle- and low-income neighborhoods.)

"The more loans you make, the better your CRA rating is," explained **Michael Reinhard**, president of Noah Bank. Noah was later spun off from Royal Bancshares at the end of 2010.

Noah is predominantly owned by Korean Americans, and serves that minority community. But, the bank has expanded and now includes Chinese-American, Indo-American and Latin-American small business customers, as well as offering financing for Jewish-owned businesses. They predominately do SBA transactions, and franchising is a space in which they've increased their presence—including with concepts like Dunkin' Donuts, Moe's, KFC, Subway and Jamba Juice, to name a few.

"In my personal experience, when you look at people who own franchises, they are not always white American," said **Bryan Doxford**, executive vice president at Noah. "A lot of immigrants come to America with the plan to someday own their own business, and franchising is a good fit with that. And that fits in with the Noah bank mentality." Doxford himself is fluent in Spanish, and is working on expanding their reach in the Latin community.

But what's also interesting is how they've turned this notion on its head, especially in the franchise sector. "The Community Reinvestment Act states we must serve all communities," said Reinhard. "It asks what are you doing to serve all communities. The light bulb went off: It's not good enough to just serve minorities; we also can't ignore the majority."

In 2012, they funded about $80 million to $90 million in transactions, reported **Gary Reilly**, Noah Bank senior vice president. And they've been steadily growing from there: In 2013, they did about $177 million in loan volume.

Noah will lend up to the $5 million SBA cap, but average loan size is usually about $1 million to $2 million.

While they tend to not finance start ups, "we don't have hard and fast rules where we never say never," said Reinhard. "We look at a loan package in its totality."

"We're very good at getting a handle on understanding risk and where we can mitigate it," Reilly added. "We need to weigh each deal on its merits. A lot of factors go into the decision. We're looking closer at someone with no experience."

They've financed some multi-unit deals: "In our Indo-American unit, we'd funded some Dunkin' Donuts where the operators don't just own one or two, they own 15 or 20, and sometimes we're financing 10 at a time." For one KFC operator, they recently funded a 23-store deal.

For more information on **Noah Bank**, *contact Bryan Doxford, executive vice president at 646-790-5376, or by email at bdoxford@noahbank.com.*

Auspex Capital Represents Muy Brands in Transactions

Auspex Capital, a boutique investment banking firm, advised on the following transactions for **MUY!**, a San Antonio, TX based Taco Bell, Pizza Hut and Wendy's franchisee. The company, owned by **Jim Bodenstedt**, owns and operates 390 restaurants throughout Texas and the Northeast.

• **Buy-side M&A and debt placement advisory:** Represented Muy Hamburger Partners, LLC in acquiring 70 Wendy's restaurants in Dallas-Fort Worth metroplex from Wendy's Corporation. The assignment also included securing acquisition financing including a $50 million senior secured term loan and a $12.165 million line of credit to fund remodels and new store development. The transaction was financed by a two-bank syndicate which included **City National Bank** and **Huntington Bank**.

• **Debt placement advisory:** Represented Muy Pizza Minnesota, LLC, a newly formed entity, in securing acquisition financing to acquire 54 Pizza Hut restaurants. The financing included a $10.85 million senior secured term loan and a $4.5 million remodel line of credit. The transaction was financed by **Regions Bank**.

• **Debt placement advisory:** Represented Muy Pizza Houston, LLC, in securing $44.25 million senior secured term loans, including a $42.25 million term facility to refinance existing debt and a $2.0 million revolving line of credit for general corporate purposes. The transaction was financed by a two-bank syndicate which included **Regions Bank** and **Cadence Bank**.

Auspex Capital is a boutique investment banking and financial advisory firm specializing in the restaurant industry. Auspex's services include buy-side and sell-side M&A advisory, debt placement, asset valuation, institutional private equity and mezzanine placement, sale-leaseback structuring and placement and financial restructuring. For more information, contact **Chris Kelleher**, *managing director, at 562-424-2455 or by email at ckelleher@auspexcapital.com.*

Correction

In the February issue of the Monitor, the phone number for **Rick Meiklejohn** of BMO Harris Bank was incorrect. The correct number is: 949-341-6102. You can also reach him at richard.meiklejohn@bmo.com.

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Folks, consider how easy it is to create an artisan pizza concept: All you need is an 800-degree oven, which you can buy from Hockenbergs or Wasserstrom, some quick-rising dough and Wisconsin cheese from Sysco and an adventurous produce rep to find a steady supply of unusual vegetable clippings to throw on the pizzas.

One or two of the quick pizza chains will emerge as a national player, á la Chipotle. And of course, Pizza Hut, Papa Johns and Dominos soon will offer up their own artisan pizza items. Remember this: A lot of capital is going to be chewed up in the process.

Pizza Pizza....Debt Debt
With debt so cheap and plentiful, even the old, tired pizza chains have their share of lookers. Just last month, **Apollo Global Management** acquired **CEC Entertainment** (Chuck E. Cheese pizza) in a transaction which valued CEC's $169 million of EBITDA at $1.3 billion, or around 8x. In a letter to franchisees announcing the deal, the company talked about "leveraging our strengths as the leader in family dining." Yes, leverage is the operative word in the press release.

Apollo placed $910 million in covenant-lite senior debt on Chuck E. Cheese, equal to 5.4x EBITDA. And then, for good measure, layered on another $255 million in 8% unsecured bonds just to show off. Debt to EBITDA: almost 7x.

There is so little equity in the Chuck E. Cheese deal that if mom and pop decide to hold junior's birthday party at home this summer and buy a couple of Papa Murphy's pizzas, there won't be enough cash after interest expense to pay the gas and electric bill. 'Tis a sign the debt market is all the way back to its pre-recession craziness, and then some.

Rejecting Shark Tank Money
Not everyone has easy access to bank capital.

Adam Goldberg is building a regional pizza, salad and wings brand in the Los Angeles area called **Fresh Brothers**. With 10 stores open, Goldberg's units average an impressive $1.5 million with store-level margins of 20%.

Fresh Brothers is more of a traditional take-out operation than an artisan business—there are only 20 to 30 seats in each 1,200-square-foot store. About 75% of Fresh Brother's business is take-out and delivery. "Our pizza travels well," says Goldberg.

You would think lenders would beat down the door to get at Goldberg's banking business. No. To date, Goldberg has financed the growth of Fresh Brothers using friends, family and unit-level cash flow. It's not that he isn't getting his fair share of phone calls from private equity funds and other investors who want to buy a chunk of his business. It's just that in his view, private equity wants too much from him, and at this stage of the game, he's not willing to give up a lot of equity so easily.

So Goldberg, like many other up and comers, finds himself in a quandary. The equity funds are expensive, and the banks are unwilling to fund his new unit growth needs. So he looked elsewhere to complete a $1 million debt placement with a group of private investors arranged by Innovation Capital. The debt carries a 12% coupon and is fully amortized over five years. The minimum slice was $50,000 per investor.

According to Goldberg, he pays no equity kicker and can prepay the debt at any time without penalty. The funds will be used to build four more Fresh Brothers stores—two in Los Angeles and two in Orange County.

Another restaurant operator who is eschewing private equity is John Rivers, the founder of the highly acclaimed **4 Rivers Smokehouse** in Orlando (three locations), Jacksonville and Gainesville, Fla. River's barbecue restaurants combine fast casual with a heavy take-out business.

Jo-Ann Perfido, a former CNL executive and president of Compass Advisory Services, serves as 4 River's chief financial officer. Perfido says private equity funds and investment bankers call on her regularly, but the company has chosen to finance each restaurant on an individual basis.

"We've used a combination of local banks and private investors to fund our unit expansion to date," said Perfido.

She says the 4 Rivers restaurants are so popular (the new Winter Park location averages $6.5 million), investors call about investing in the new units. In return for funding a new location, the company has offered a mid, single-digit coupon and a 25% interest in the cash flow of the new restaurant. The company, whose goal is to build 24 company stores, hasn't had any trouble finding investors.

More on Furr's
My article on Furr's bankruptcy last month brought forth a number of comments from readers. Former Furr's and Ruth's Chris CEO, and now Orlando restaurateur, **Craig Miller**, wrote to tell me the declining customer base and severe facilities neglect I wrote about were accurate.

However, Miller suggested I failed to point out a couple of important extraneous events that exacerbated Furr's financial downfall in 2003. First, the 9-11 terror attack hit Furr's hard, especially because of intense competition at the time from the all-you-can-eat buffet chains. Furr's, as you recall, was a straight-line cafeteria. The second event was the Kmart bankruptcy (Furr's former owner) early in 2002. This triggered Furr's assumption of almost $10 million in pension liabilities.

Miller told me the new Furr's buffet concept, which launched in West Texas in 2001, showed promise. However, the leveraged balance sheet and out-of-favor, straight-line cafeteria model format made the financial restructuring a necessity in order to survive and provide the necessary cash flow to expand a newer version of Furr's.

—John Hamburger

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That product has a strong reputation. Its S-1, filed with the SEC last week, has loads of examples in which the chain had top consumer rankings among pizza concepts. Though it doesn't cook its pies, parents love the concept because it makes them feel like they're giving their kids a home-cooked meal.

Thanks to the company's no-cook model, stores can go anywhere and be built for $200,000, and can make profits on real low volumes. That's great for operators, three-quarters of whom own just one or two units.

All pizza is not created equal

Sbarro doesn't have Papa Murphy's reputation. When the chain filed for bankruptcy the first time, it was ridiculed as "America's Least Essential Restaurant" by the online publication Slate. Instead, the chain has relied on retail shoppers who are hungry and want something quick and easy.

There are two problems with that model. First, there aren't as many shoppers. According to the retail information firm ShopperTrak, retail foot traffic fell 14.6% during the most recent holiday shopping season, a season Sbarro depends upon for all of its profits. Fewer shoppers = fewer customers.

Second, the chain reheats pizza right in front of customers, in an era when they've become accustomed to having their food made in front of them. One of our favorite local Twin Cities restaurants, Punch Pizza, makes its pizza fresh in front of me in two minutes—the same amount of time it takes Sbarro to reheat that warmed slice. Why on Earth would I go to Sbarro?

The chain badly needed to change that business model when it filed for bankruptcy in 2011. And there were some indications that it planned to do so. The chain emerged from debt protection, having reduced its debt load from $400 million to $130 million. It had $35 million in investment, and a new CEO in Jim Greco who had turned around Bruegger's. It closed some underperforming units and renegotiated leases. The company projected that its EBITDA would be $25 million in 2012, and then $31 million in 2013.

Greco left the company a year ago. And the company didn't change its business model enough. Customers avoided the chain. That was trouble for a chain that relied on high-rent, high-traffic retail sites. EBITDA fell to $13 million in 2012, and then to less than $4 million in 2013. Meanwhile, interest payments on the debt were $17 million a year.

The company needed to close more units, sell more locations to operators, and change that reheat-and-eat business model. "It's a mistake to be too conservative in bankruptcy the first time," said Jeff Posta, a bankruptcy attorney with the Princeton, New Jersey law firm Stark & Stark. "You want to deal with the issues the first time. The issues could be a bad business plan. Or bad management. If you don't deal with that, or you're not financially situated coming out of the first bankruptcy, then you just do it half way, and you're worse off."

Quality concerns haven't been the problem at Quiznos. We love the food there. But as much as the quality of food matters, everything else matters, too. Especially franchisee profits.

The chain's filing is the culmination of a rapid implosion of the company's store base. It had 4,636 domestic units in 2007. It has less than 1,200 in the US today. That's a decline of 74%. In that time, its unit volumes declined from more than $400,000 in 2007, according to the company's FDD, to less than $300,000 today, according to sources. (The company has 2,100 units total, including international.)

Papa Murphy's can earn profits with remarkably low-unit volumes. Quiznos couldn't do that. The company charged franchisees a 7% royalty, a 4% ad fund contribution, and then marked up its food costs an estimated 6% to 7% through its American Food Distributors subsidiary. That's an 18% premium to be a Quiznos franchisee. Or about $54,000 a year for the average operator.

Not surprisingly, operators quit taking coupons, which angered customers. They cut corners, which hurt the chain's quality. And then they started closing, which left customers wondering whether the brand was still around, while also sapping valuable ad fund dollars.

Quiznos could have fixed these problems, by simply starting a food co-op with franchisees and working on profitability. But a 2006 leveraged buyout, and a 2008 refinancing, left the chain with $800 million in debt. Two years ago, it was near bankruptcy, but one of the lenders, Avenue Capital, instead traded its debt for equity, leaving $600 million in debt. That was still too much leverage, leaving the chain unable to fix the business model. So franchisees kept closing, and ultimately bankruptcy was filed, anyway.

The next generation of restaurant includes places like Zoe's Kitchen. Started in Birmingham, Ala., in 1995, the Mediterranean chain specializes in healthy food that's consumed at both lunch and dinner. The company's average unit volumes have grown by a third since 2010—now at $1.47 million—and the company hopes to continue to add to those volumes in the coming years.

The chain has lured loyal customers, many of them women, thanks to its wide variety of healthy items, catering to a modern demand for food that addresses numerous dietary needs, such as vegetarian, vegan or gluten free. But, in short, the company is healthy, fresh and new and relatively quick—which is exactly what customers want in a chain right now.

None of this is to say that old brands can't do well. That's obviously not true, as any large franchisee with a bunch of Arby's or Burger Kings that are raking in cash every year can attest. But the bankruptcy and IPO filings this month do demonstrate the need for companies to invest in their businesses. They need to operate well, to make sure their food tastes good, and their facilities are updated. If they don't, consumers are going to go elsewhere. They just don't eat out enough to tolerate anything less than what they really want.

— Jonathan Maze

Some New Thoughts on Labor Costs

by **Dennis Monroe**

I've been reading everything I can to come to my own conclusions about proper approaches regarding impending increased labor costs for the restaurant industry. I also talk daily with multi-unit operators to get their take.

The threats for increased labor costs are from multiple sources, including minimum wage at the local, state and federal level; disparities in minimums between states; the movement to a livable wage; the Affordable Care Act and confusing wage and hour laws.

Given all of the above pressures, what are the fallacies regarding increased labor costs?

1. The current environment is bad. The fallacy is the increase in wages will have a dramatic effect on the restaurant industry. Restaurants already pay far above the minimum wage, so an increase usually does not have a significant adverse effect. It may help the servers, but there is a continuing movement in the country to implement tip credits or a two-tiered minimum-wage system. The recent Congressional Budget Office said an increase in the current federal minimum wage from $7.25 to $10 could result in 500,000 job losses, but would mean 16.5 million workers with more buying power.

2. The restaurant industry will not be able to raise prices. The restaurant sector has hurt itself as it relates to pricing because of couponing and dollar menu wars. Hopefully, with an increase in wages we'll see a decrease in couponing, prompting diners to seek quality rather than bargains.

3. Restaurants will go from profitability to losses. It's always been the case if your sales volume is close to break even, anything that causes the break even to go up may result in a loss. Many restaurants are profitable, and their profitability flow through is in the 40%-to-50% range. If restaurants are unable to raise prices, the effect on operating profits will be incremental, which most operators can deal with.

4. Little can be done if labor costs go up. This is totally false. It is about time the restaurant industry gets a handle on efficient labor vs. straight labor costs. There are a number of techniques that have been used which we will discuss below.

5. Obamacare is going to destroy the restaurant industry. The cost of Obamacare has turned out to be much ado about nothing. I have seen restaurants planning to go healthcare-lite and using more part-time workers in order to manage healthcare costs. But having healthcare may create a higher level of employee retention, which would then cut the overall labor costs and compensate for the extra healthcare costs.

Now let's look at some solutions:

1. Flexible Labor. Chain restaurants are developing market labor forces rather than an individual restaurant workforce. Employees can work in more than one restaurant, allowing for flexibility, and limiting labor costs and last-minute scheduling. This flexible labor force will reduce no-shows and overall labor costs, and it will keep employees happier because they will work more hours.

2. Natural increases in prices. There always has been a natural increase in prices, and it will continue. If there is any increase in labor costs, restaurants will need to find effective ways to raise prices. Some creative ways include increasing the price on key products, particularly signature products; cutting back on frequent dining cards and, as I said before, limiting couponing and Groupon.

3. Offering Better Service. With higher wages, employers should expect better performance from employees. This higher expectation starts with the front of the house and goes to the back. Operators must let their servers know how important they are and how successful they can be. Increasing their wages is a good start.

4. Cost Containment—Negotiating Leases. If labor costs go up, then one possible source of cost containment may be leases. Most restaurant leases have periodic increases in rents over the life of the lease. Limiting these increases may be a way to compensate for higher labor costs.

5. Use Less Labor. iPads and electronic ordering seem to be the way of the future. The unknown factor is: Will electronic ordering cut overall labor costs? It probably won't affect the back-of-the-house labor outlay. I do think technology will be a savior of labor costs across segments.

6. Effective Up-Selling. It's crucial every employee try to up-sell customers. It should be effective up-selling, however, not just up-selling to irritate the customer. This skill can be taught. For example, take an order for dessert from the start, or package menu items as combos and pairings.

7. Watching Tables. All employees should do consumer research by watching tables, noticing customer reactions and responding. Focus on customers. If that is maintained, the restaurant will have better-trained employees.

8. The Future. The restaurant industry is innovative. Thanks to the evolution of fast casual, the trend already is away from high labor costs and tips. Consumers are willing to pay more for food than they are sometimes for service, and that can be a guide to lower labor costs.

9. What Would the Answer Man Say? These questions would be better answered by the Answer Man, but he refused to return my call. So this liberal lawyer had to think outside the box. The restaurant industry thinks creatively. We challenged QSR, fast casual and casual dining to come up with innovative ideas. Those who break out like McDonald's in the 1950s or Chipotle in the 1990s will be the winners. There are huge opportunities to make money in the industry. Do not let labor concerns hold you back. The weakness has never been labor cost; the weakness has always been weak performance, bad products and lack of a compelling offer.

Dennis L. Monroe *is a shareholder and Chairman of Monroe Moxness Berg PA, a law firm specializing in multi-unit franchise finance, mergers and acquisitions, and taxation. Reach him at (952) 885-5999.*

Will the New Tavern on the Green Succeed?

"The Tavern on the Green building will reopen to the public later this year," promises the restaurant's website. For now, the Manhattan eatery is still undergoing a multimillion-dollar facelift, courtesy of New York City and Summit Partners. The refurbishing will shrink the glamorous new restaurant from about 28,000 to just 11,000 square feet—still large by today's restaurant standards.

A spokesman for the city, which owns the 143-year-old building, said it has poured nearly $16 million in the "restoration of Tavern on the Green's core and shell."

The lending arm of the Boston-based private equity firm, Summit Partners Credit Advisors, loaned the restaurant's new concessionaires, creperie operators from Philadelphia, a reported $16.7 million under terms that include a five-year payback. The partners are renovating the interior, which will feature an open kitchen and a separate barroom.

Summit Principal Jack Le Roy (no relation to flamboyant former Tavern on the Green owner Warner LeRoy, whose family operated the eatery from 1974 to 2009) did not return emails seeking why the loan made sense. A spokeswoman told me the firm doesn't comment on transactions.

Meanwhile, much has been written about the Central Park eatery's rebirth, some of it unkind. Last August, for example, New York Post restaurant scribe Steve Cuozzo questioned whether Jim Caiola and partner David Salama had the experience to run the iconic eatery. He suggested they might have landed the deal—and a union contract—because of their connections: "Caiola's sister is married to [Mayor Michael] Bloomberg's friend, former deputy mayor and campaign manager Kevin Sheekey, who's now a top honcho at Bloomberg LP. (All, of course, deny any favoritism.)."

The Emerald Green Group—the name of Caiola and Salma's company—has also inked an agreement with Union 6, which represents hotel and restaurant service workers, said to allow initially for a non-unionized workforce.

By the time of Caiola and Salma's bid, the mayor had rejected several multimillion proposals to lease and refurbish Tavern on the Green, including one worth $86 million from the late LeRoy's daughter, Jennifer. The city then tapped restaurateur Dean Poll, who operated another concession in Central Park, to run the restaurant. But he failed to come to an agreement with the New York Hotel and Motel Trades Council (Union 6) and the deal was off.

Several well-known New York City operators meanwhile toured the large space and decided against bidding for it. "I heard that a lot of top operators looked at it, but the deal was too rich—and some were afraid of the union," says New York-based restaurant consultant Michael Bonadies, a captain at Tavern on the Green for three years in the 1980s.

Part of that richness is rent, which climbs from 6 percent of gross receipts in year one (vs. $1 million) to 15.5 percent (vs. $3,273,000) in year 20. In all, the lease is worth at least $39 million to the city of New York. By contrast, LeRoy paid 3.5% of gross receipts. Tavern on the Green was reputed to gross $34 million a year. Bonadies worries that loan and rent payments alone could hobble cash flow this time around. "You don't want vendors calling your chef," he says.

Investment banking firm Trinity Capital Founder and Managing Partner Kevin Burke, who brought the deal to Summit, dismisses such concerns. He insists Caiola and Salma are talented operators. "Their brassiere in Philly was just printing money and very well managed," he says.

Still, the partners hadn't dealt with institutional lenders before Burke showed up. "We tried to polish them up a bit and get them ready for prime time," he says. Asked by email what they learned in the process, Caiola and Salma said, "How difficult it is to fund an independent restaurant."

Tavern on the Green is hardly your garden-variety independent. "You could have a magical experience there," Bonadies recalls, referring to elaborate lighting and décor Leroy had installed. Today, the 500-seat restaurant "will still have a glass-enclosed section as part of its dining area, but one that looks more like an Apple store than the famed Crystal Room, which the late Werner LeRoy added in 1976," the New York Times reported in October.

Diners will be able to watch Executive Chef Katy Sparks and her crew cooking their heavy-duty Jade Range grills and griddles. "When you're walking through, you're going to be seeing flames over to your right," Caiola told Zagat.com early this year. The partners also are refurbishing the multi-purpose space, featuring exposed timber rafters, for à la carte dining and private events. But unlike the past, the restaurant's reputation (or profits) won't depend on elaborate private parties. In fact, the city's RFP made clear it would "approve only a limited number of events that would require closure of the restaurant entirely."

"First and foremost, Tavern on the Green is a New York restaurant. We want to stress that we will not be a catering facility," the partners insisted in their email, adding that catering will account for just 15% to 20% of revenue. They also noted a $60 check average, though it's not clear whether the figure includes beverage, tax and tip.

That may seem pricey to some, but remember Tavern on the Green is an iconic eatery in a city that attracted 54 million visitors last year, 3 percent more than in 2012. Moreover the city is a dining destination for many tourists. Says Bonadies: "That bodes well for this project. Tavern on the Green will become one of their stops."

— David Farkas

Papa Murphy's

Initial Public Offering

Date Announced: March 12, 2014
Funds to be raised: $70 million
Underwriters: Jefferies & Co., Robert W. Baird & Co., Wells Fargo Securities, William Blair, Raymond James, Stephens Inc.
Use of proceeds: The company plans to use the proceeds to pay debt and to make a $31.5 million payment to preferred shareholders.

INCOME STATEMENT

Year ended December 31, 2013

Revenues:......................$80,495,000
Net Loss:...............................($2,572,000)
Net Loss Per Share..........................($5.29)

BALANCE SHEET

As of December 31, 2013

Cash:.................................$3,705,000
Debt:.................................$170,000,000
Shareholders' Equity:............$33,925,000

SUMMARY:

Papa Murphy's, a 1,400-unit, take-and-bake pizza chain based in Vancouver, Wash., filed papers for a $70 million IPO earlier this month. Lee Equity Group, which bought the chain in 2010, is the company's sponsor. The concept will trade under the ticker symbol FRSH.

Murphy's is the leader in the take-and-bake business. Because the company doesn't cook its food on site, it can go into a number of locations and be built for $200,000. And it can make a profit at remarkably small volumes.

Stores average about $577,000 in revenue a year. Three quarters of the company's franchisees have one or two locations. On average, stores generate 15 percent EBITDA after royalty and ad fund payments, but before the manager's salary. The company has grown steadily over the years, from 841 units in 2004 to 1,418 this year. System sales last year were $785.6 million.

Zoe's Kitchen

Initial Public Offering

Date announced: March 10, 2014
Funds to be raised: $80.5 million
Underwriters: Jefferies & Co., Piper Jaffray, Robert W. Baird & Co., William Blair, Stephens Inc., Stifel.
Use of proceeds: The funds will be used to pay off debt, and to fund growth.

INCOME STATEMENT

Year ended December 31, 2013

Revenues:.....................$116,385,000
Net Loss:................................($3,715,000)

BALANCE SHEET

As of December 31, 2013

Cash:................................$1,149,000
Debt:............................$61,650,000
Shareholders' Equity:............$33,579,000

SUMMARY:

The 102-unit fast-casual Mediterranean chain, Zoe's Kitchen, wants to go public and use the money it raises to fund growth and pay off debt. The company's equity sponsor is Brentwood Associates.

The chain's sales have been on a tear in recent years. Same-store sales rose 11.9% in 2010, 11.8% in 2011, 13.4% in 2012, and 6.9% in 2013. Unit volumes have increased by a third, to $1.47 million. The company does 60% of its business at lunch, 40% at dinner, and has a healthy catering business.

New units cost $750,000 to build and have 30% cash-on-cash returns. The company has grown from 21 locations in 2008 to 102 now. It built 27 units last year, and plans to build 28 to 30 new locations this year. It is a mostly company-owned business, with just eight franchisee-owned units. The company hasn't added a new franchise location in years.

Sbarro LLC

Chapter 11 Filing

Date filed: March 10, 2014
Debtors: Sbarro LLC
Largest secured creditors: Apollo Global Management, Babson Capital Management, Guggenheim Investment Management.
Debt: $148.5 million
Largest unsecured creditors: Vistar Corporation ($536,516), 421 Seventh Avenue LLC ($210,040), 1604-1610 Broadway Owner LLC ($122,008), Annapolis Mall Owner LLC ($113,983).

SUMMARY:

Sbarro filed for bankruptcy for the second time in three years earlier this month, after the company badly missed projections for earnings established in its previous filing. The company filed a prepackaged bankruptcy, approved by 98% of its creditors, that would swap the company's $148.5 million in debt for equity.

The company would emerge from bankruptcy with $20 million in debt. It would also have fewer locations. The chain has closed 180 unprofitable locations, and wants to close another 50. It also wants to sell 50 profitable locations to franchisees as a way to raise cash. Sbarro has an "overbid process" to see if someone comes forward with an offer better than the one accepted by creditors, but given that the chain reported $4 million in EBITDA last year, that seems unlikely.

Sbarro previously filed for bankruptcy in 2011. In that action, it reduced debt from $400 million to $130 million, closed some unprofitable locations and renegotiated leases. But it apparently wasn't enough.

The Quiznos Master LLC (Quiznos)

Chapter 11 Filing

Date filed: March 14, 2014
Included in filing: American Food Distributors, the company's distribution arm and the National Marketing Fund Trust and The Regional Advertising Program Trust.
First- and second-lien lenders: Avenue Capital and Fortress Investment hold approximately $450 million of pre-petition first-lien debt. Approximately $173.8 million of second-lien debt is held by various funds.
Largest unsecured creditors: Horizon Media ($3,677,730); MG-1005, LLC ($3,625,000); Maple Leaf Bakery ($1,648,102); ESPN ($909,441); Alix Partners ($379,451).
Pre-packaged Plan: First-lien lenders—Avenue Capital and Fortress Investment—will receive a pro-rata share of a new $200 million first-lien credit and equity in the new entity. The second lien lenders and unsecureds will receive equity and a right to recover money in a lawsuit to be brought against Quizno's former owners and officers in connection with a 2012 restructuring.

SUMMARY:
Quiznos' pre-packaged bankruptcy filing represents the culmination of a years-long collapse, one that took the chain from a peak of 4,636 domestic locations in 2007 to less than 1,200 traditional locations today. And a collapse that has had numerous sources, both internal and external. In Quiznos' case, the company's business mode—poor franchisee profitability—took the chain from one of the hottest franchises in the country, to one of the sector's most derided franchises. (Overall, the chain has 2,100 locations, including international units.)

In 2006, the Schaden Family sold a significant minority interest in the concept to JP Morgan, in part by using $600 million in debt placed on the company. In 2082, a refinancing brought its debt level to $800 million, later reduced in a 2012 restructuring.

Biglari Holdings

BH · NASDAQ

Purchase of Maxim

Date announced: February 27, 2014
Price: Undisclosed

INCOME STATEMENT

Fiscal year ended September 25, 2013

Revenues:....................$755,822,000
Net Earnings:......................$140,271,000
Diluted Earnings Per Share.............$98.11

BALANCE SHEET

As of December 18, 2013

Cash:.................................$78,460,000
Debt:............................$97,500,000
Shareholders' Equity:.........$584,961,000

SUMMARY:
Sardar Biglari, the San Antonio investor that trys to emulate Warren Buffet, owns Steak 'n Shake, Western Sizzlin and a 20% interest in Cracker Barrel. Now, he is trying his hand at the publishing business. His mantra as "the sole capital allocator — unrestrained by institutional limitations," apparently has spurred him on to acquire Maxim, a soft-porn magazine and website known mostly for its cover photos of sexy young women, along with humor articles. Among them: "Seven Best Movie Fart Scenes."

Biglari Holdings has long billed itself as an owner of businesses in multiple industries á la Buffett, but thus far has concentrated mostly on restaurants, which has generated SEC regulator concerns. By purchasing Maxim for an undisclosed price—probably cheap—Biglari gets to be truthful in that assertion.

The only question is what he does with the publication. There's no word on whether Biglari, who has put photos of himself surrounded by workers in Steak 'n Shake restaurants, plans to do something similar in Maxim.

For restaurant watchers, Steak 'n Shake's same-store sales increased 3.0% during the first quarter of 2014, and customer traffic increased by 2.6%.

Red Lobster Seafood Co.

Darden files to separate Red Lobster

Date filed: March 10, 2014
Stock to be transferred: Darden Restaurants stockholders will receive shares of stock in Red Lobster. Total shares, and the date of the transaction, have not yet been set.

INCOME STATEMENT

Six months ended November 24, 2013

Revenues:....................$$4,208,400,000
Net Earnings:....................$90,000,000

BALANCE SHEET

As of November 24, 2013

Cash:................................$84,600,000
Long Term Debt:............$2,480,100,000
Shareholder's Equity:.....$2,059,200,000

SUMMARY:
Despite opposition from activist investors, and even some analysts, Darden Restaurants is pressing ahead with its spinoff of Red Lobster, saying the brand needs more focused attention. It does. Both Red Lobster's sales and its earnings have been falling. The chain's net earnings fell from $46.6 million to $8.2 million in the first six months of the current fiscal year, while sales fell 5%.

In spite of steadily falling earnings, the company plans to borrow money and pay out regular dividends.

Red Lobster has 678 restaurants, with average unit volumes of $3.7 million. The new company plans to leverage its brand by selling products in grocery stores, such as its Cheddar Bay Biscuits.

CHAIN INSIDER

Don't be surprised if Bob Evans gets taken over by activists. A source told The Monitor recently the company offered **Sandell Asset Management** three spots on its board, but Sandell turned them down. Instead, the activist investor could be gunning for most, if not all, the board. The guess here is that it'll get its wish. Bob Evans investors have a history of frustration with the company and its board. And the company's recent decision to lower the bar for shareholders to make changes in the bylaws and the board—driven by lawsuits against the company—would make it easier for Sandell to accomplish its goal.

Good luck, John Gilbert. The former **Famous Dave's** CEO recently took the helm at **Ignite Restaurant Group's Macaroni Grill**. Gilbert will have his work cut out for him. The chain's same-store sales fell 9% in the fourth quarter of last year. And the brand lost $19.9 million for the full year. The good news: Mac Grill has plenty of value in its real estate. Indeed, Ignite is converting underperforming Mac Grill units to either **Joe's Crab Shack** or **Brick House Tavern**.

Apollo Global Management is apparently trying to corner the market on food-and-games chains. The big private equity firm, fresh off of its acquisition of **Chuck E. Cheese,** is apparently considering a bid for none other than **Dave & Buster's**, which is like CEC for adults. **Oak Hill Capital Partners** apparently wants $1 billion for Dave & Buster's, and is considering either a sale or an IPO, according to Bloomberg.

Those of you following the Darden Restaurants dispute might pay some attention to the people activist shareholder Starboard Value is bringing aboard its effort. One is **Brad Blum**, who was president of Olive Garden in the 1990s. Another is **Charles Sonsteby**, former CFO at Brinker International. The third is **Bob Mock**, who has spent most of his career at—you guessed it—Darden. It's fairly common for investors to recruit former executives of the companies they target as consultants, but employing that extensive a roster is unusual.

Speaking of Brad Blum, the chain he tried taking over a few years ago, Cosi, is in danger again. The Illinois-based bakery-café chain is in a desperate search for financing following years of sales declines and financial losses. The company's same-store sales fell 18% in January, and 13.8% in February. The chain is looking for financing. At the end of 2013, the company said, it had just over $6 million in cash, but its sales declines have reduced that balance further.

Could Quiznos sue the Schadens? As part of its bankruptcy plan, the company is planning to sue "certain litigation parties" over what the company's lenders, and now owners, consider to be overly optimistic projections dating to the company's reorganization two years ago. Those "litigation parties" could include former company executives, such as former CEO Greg MacDonald, and the Schaden family, the chain's former owners.

Bob Bourne has left **CNL** after 30 years. Most recently, he was vice chairman of CNL Financial Group.

In other Apollo news, Lance Milken, the son of the former '80s junk-bond trader**, Michael Milken of Drexel Burnham Lambert,** is a partner at **Apollo Global Management.** Milken serves on the board of directors of **CEC Entertainment**, which was recently acquired by Apollo.

Project Pie, an artisan pizza concept developed by entrepreneur **James Markham,** recently announced a partnership with **Lee Equity Partners**. Lee is no stranger to the pizza business—it owns a majority stake in **Papa Murphy's,** which owns approximately 26% of Project Pie. **Todd Owen**, formerly of **Qdoba,** is now VP of franchise development. Project Pie has two company and five franchised stores. Four new units are under construction and the company plans 15 to 20 openings in 2014.

Mark Whittle, senior vice president, global development at **Hooters of America** reports the company completed 16 remodels on corporate stores in 2013 (at an average cost of $350,000) and have ramped that up to 30 per year for 2014 thru 2018. Hooters is owned by a group of private equity funds including **H.I.G. Capital** and **Karp Reilly**.

The U.S. Government is seeking a judgment against former **Jack In The Box** franchisee **Abe Alizadeh** in the amount of $7.5 million for unpaid employment taxes. Alizadeh's companies filed bankruptcy in 2010 and in a successful auction conducted by **National Franchise Sales**, his 70 restaurants were sold to various restaurant operators The government is seeking a permanent injunction requiring Alizadeh to comply with federal employment tax laws in his ongoing businesses.

Zoe's Kitchen, **which filed to go public this month, has an all-star board of directors** including **Greg Dollarhyde**, CEO of **Veggie Grill**; **Rahul Aggarwal**, managing director of **Brentwood Associates**; **Thomas Baldwin**, CEO of ROI Acquisition Corp. and former **Morton's** CEO; and **Sue Collyns**, former COO of CPK.

Yum Brands
YUM-NYSE
(Outperform)
Recent Price: $75.00

Yum Brands is the Louisville-based operator of KFC, Taco Bell and Pizza Hut. The company operates or franchises 40,000 restaurants in 125 countries.

Baird Analyst **David Tarantino** upgraded Yum Brands stock to Outperform, giving the company an $87 price target, noting that he expects the company to release a series of positive reports. "the time has come for investors with 6-12 horizon to begin building/increasing positions, given prospects for a series of positive quarterly reports in 2014 as China business recovers," he said. The company's stock has been underperforming lately. He believes the stock deserves a premium valuation because of its "substantial growth opportunities," its defensive business profile and its cash flow. He said that a "major China recovery seems possible," noting that the business is poised for a rebound this year. He's projecting comps growth of 10% and profit growth of 38%. He said the company has solid positioning there across segments and has upcoming sales drivers. Outside of China, Tarantino said the outlook is "solid." He also expects continued momentum for Taco Bell, and KFC and Pizza Hut should take share in "high-ROIC emerging growth markets."

Bob Evans Farms Inc.
BOBE-NASDAQ
(Outperform)
Recent Price: $49.27

Bob Evans Farms is the Ohio-based owner of the Bob Evans chain of family dining restaurants, which has 561 locations in 19 states. It also has a food products business to sell food in grocery stores.

Bob Evans recently released an ugly report from its fiscal 14 third quarter, one that forced it to cut its projected earnings guidance for the second time. EPS this year is now expected to be $1.60 to $1.75, down from its $2.20 to $2.30 projection and well below the $2.60 to $2.70 projection six weeks ago. Still, **Oppenheimer** Analyst **Brian Bittner** remains optimistic. He noted that the company's initial 2015 outlook suggests "75%-ish" EPS growth." Bittner acknowledged that many will question management's credibility, "but our analysis suggests EPS above $3/sh is very possible as the butterfly-effect takes form." Many stranded costs disappear, he says, "while restructuring benefits are absorbed and temporary 14 headwinds are lapped." He also pointed out that Bob Evans has some silver linings in what were some ugly same-store sales numbers, when they fell 1.8%. He noted that 3% of that was due to weather, and he noted that comps grew 4.4% in Florida for the quarter, when weather wasn't a factor.

Darden Restaurants
DRI-NYSE
(Market Perform)
Recent Price: $49.22

Darden Restaurants is the big, Orlando-based operator of casual dining restaurant chains. The company operates Olive Garden, Red Lobster, LongHorn Steakhouse, The Capital Grille, Bahama Breeze, Seasons 52, Eddie V's Prime Seafood and Wildfish Seafood Grill. It has a total of 2,100 restaurants.

Darden Restaurants filed documents with the SEC to separate Red Lobster, demonstrating that the chain has seen fallen sales and earnings in recent years. **Bernstein Research** analyst **Sara Senatore** wasn't that impressed. She noted that the financial results "reflect the steady decline of the brand and diminished profitability." She also noted that the company "is likely to use leverage to support a high payout," but "a shrinking cash flow from operations raises questions about this strategy." She also questioned the overall strategy of divesting Red Lobster. "We are not convinced that a spinoff of Red Lobster is the optimal strategy for Darden to pursue and its persistence in the face of criticism from activists—and increasingly traditional shareholders—underscores questions about capital stewardship."

ANSWER MAN

Answer Man Longs for Spring

Restaurant owners have made a lot of noise about the lousy weather this past winter. Traffic always bounces back when weather improves, doesn't it?

When it snows on one Friday or Saturday night in a winter season, restaurants can easily recover. When the weather is bad for an entire month or two, those sales don't come back. Bad weather places an enormous strain on restaurant cash flows. Rent, taxes, CAM, insurance, trash, manager salaries, gas, electric, water and debt payments are all fixed and must be paid whether the sales are good or bad. I remember when working for a casual dining chain 30 years ago, we had six straight weekends of snowstorms. It didn't kill us, but almost. I wouldn't be surprised if weather is to blame for a few chain bankruptcies this spring. At the least, there will be a good number of chains that bust their bank covenants.

What do you make of all the activist activity in restaurant chains such as Cracker Barrel, Famous Dave's, Bob Evans and Darden?

One thing you can say about the activists is they know how to make money for themselves. Most of them couldn't manage a candy store, but they sure can churn out the noise. Sardar Biglari has made a bundle the past two years coaxing other investors into believing Steak N Shake is gold-plated and that he wants to take over Cracker Barrel. Activists really don't want to run these things. Famous Dave's is another interesting situation: It's not a growth business. Its restaurant operating margin right now isn't worth the big investment. Yet, the activists get involved and double the stock price in a year. Will they pay a premium to acquire the entire business? I doubt it. Then they'd have to figure out how to make consistent money selling barbecue. That's a tall order.

How does the Fed's policy of ultra-low interest rates impact the restaurant business?

Low interest rates are spurring consolidation among franchisees, for sure. With profits under siege from rising operating costs, a multi-unit operator has to run a bigger operation to make the same amount of money he made running fewer stores. Technology has made it easier to do this, but the low rates and capital availability are what's driving the consolidations. The low rates also have egged on the speculative private equity and hedge funds who don't realize they are paying premium multiples to buy depreciated restaurant assets. They'll realize it one day.

There is a lot of interest in up-and-coming restaurant companies. What's the reason for all the excitement?

They're new. Older brands look tired. Restaurants that look old and tired shouldn't be surprised if their sales drop.

People like new stuff. Any customer, it doesn't matter what their income level is, wants to eat in a new restaurant. The eateries that smell terrible, have sticky booth seats, or ones where the customer must dodge moon craters in the parking lot, not so much. You can tell when a restaurant needs extensive remodeling. Just walk into the bathroom. The bathroom is the last place a restaurant owner wants to spend money, yet it is one of the most important indicators of how vibrant the place is. Thank God most of QSR's business comes through the drive-thru. I've known a few operators over the years who would opt for a hole in the ground if they could get away with it.

Is there anything we should glean from the Sbarro or Quiznos bankruptcies?

That both had too much debt is obvious. When the shopping mall was king, Sbarro was one profitable concept. I can remember Mario Sbarro and his accountant Bernard Zimmerman waltzing into Wall Street money manager meetings in the '80s and crowing about the chain's expansion possibilities in the malls. In 1994, Sbarro's EBITDA margin was 26%. It had zero debt. How can you screw that up? That was before Amazon, though, and back when developers were still building shopping malls. Then you sell the company to private equity bumblers. They slap too much leverage on the business and start serving crap in the stores to improve margins. That poops out the party real quick.

Quiznos is one of the saddest tales in the restaurant business. Many franchisees were not only financially drubbed, but emotionally destroyed, too. High royalties, ad fees, and big markups on food distribution and equipment were so onerous, average performing franchisees never had a chance. The Quiznos promoters, son-and-dad team Rick and Dick Schaden, got their big payday in 2006 when they sold half their interest to private equity. Eventually, the pair's remaining equity was washed out in a restructuring, but in my opinion, they made the big money and left a miserable legacy.

Answer Man is a former restaurant executive who claims to tip servers at least 20%. He refuses to put money in a tip jar at fast casual joints, however, and wonders who came up with that terrible idea.

RESTAURANT FINANCE MONITOR

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